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EX PARTE OR LATE FILED

ORIGINAL

June 9, 2000

**EX PARTE**

Ms. Magalie R. Salas  
Secretary, FCC  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

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JUN - 9 2000

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

**Re: CC Docket No. 98-137**

Dear Ms. Salas:

Today, Mary L. Brown, Senior Policy Counsel, WorldCom, Inc., submitted the attached letter regarding the Commission's Notice of Proposed Rulemaking in the above-captioned docket to Mr. Lawrence E. Strickling, Chief, Common Carrier Bureau.

As required by Section 1.1206(b)(2) of the Commission's rules, I am filing two copies of this notice for placement in the record of this proceeding.

Sincerely,

Alan Buzacott

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**EX PARTE OR LATE FILED**

June 9, 2000

Mr. Lawrence E. Strickling  
Chief, Common Carrier Bureau  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Re: CC Docket No. 98-137; Review of Depreciation Requirements

Dear Mr. Strickling:

In their latest *ex parte* letter in this proceeding, submitted to you on June 1, 2000, the CALLS ILECs purport to demonstrate that their proposal for a five-year above-the-line amortization "is entirely consistent with State Public Service Commission practices." They suggest that "nine states have chosen to deal with the reserve difference through an amortization while in 26 states the reserve difference is being reduced through shorter depreciation lives."

The table attached to the ILECs' June 1, 2000 letter is misleading, and provides no support for the above-the-line amortization that the ILECs are proposing in this proceeding.

**State Commission Practices Provide No Support for the ILECs' Proposed Above-the-Line Amortization**

Significantly, the ILECs have provided no citations to the state commission decisions that allegedly "deal with" the "reserve difference" via amortization, making it impossible for the Commission to verify the form of relief, if any, permitted by the listed states. Under these circumstances, the Commission can give no weight to the ILECs' assertion that these states' actions are "consistent with" the relief the ILECs have proposed at the federal level.

To the best of WorldCom's knowledge, none of the states shown by the ILECs as "dealing with" the "reserve difference" via amortization has granted relief that is comparable to that sought by the ILECs in this proceeding. WorldCom is not aware of any state commission that has established an amortization whose objective is to eliminate the differential between the ILECs' regulatory and financial reserve levels. Certainly, WorldCom is not aware of any state commission that has recognized for ratemaking purposes amortization expense associated with increasing ILEC depreciation reserves to

"financial" levels (i.e., accorded above-the-line treatment to such an amortization).

At least one of the states that the ILECs have listed as permitting an amortization -- Illinois -- has explicitly rejected the type of relief that the ILECs are proposing in this proceeding. When the Illinois Commerce Commission (ICC) adopted an alternative regulation plan for Ameritech in 1994, Ameritech proposed that the ICC allow a five-year amortization of the \$559 million difference between Ameritech's regulatory and financial reserve levels, and also proposed that the ICC permit Ameritech to recognize the amortization expense for ratemaking purposes. The ICC rejected this proposal, permitting only a much smaller amortization for one account (analog switching, which Ameritech was rapidly phasing out):

"The Commission rejects the proposal of [Ameritech-Illinois] and Staff that the accumulated depreciation reserve deficiency be amortized over a five year period. The Commission finds that the remaining life depreciation methodology which allows for recovery of any reserve imbalance over the life of the account is appropriate. In Docket 86-0458 the Commission determined that the amortization of the reserve deficiency was an extraordinary remedy. With the exception of the analog switching reserve deficiency, the Commission believes that there has been an inadequate demonstration as to why there is a need to invoke the extraordinary remedy of amortizing the reserve deficiency."<sup>1</sup>

To the best of WorldCom's knowledge, most amortizations established by state commissions and recognized for ratemaking purposes have, like the Illinois example, dealt only with specific accounts in which the state commission found a reserve deficiency or surplus after a depreciation rate represcription. No state has established and recognized for ratemaking purposes an amortization designed to eliminate the entire differential between an ILEC's financial and regulatory books.

Some of the "amortization" states shown on the ILECs' list appear to be states where the ILEC is no longer required to seek approval from the state commission for its depreciation practices (often because state law required the state commission to deregulate depreciation<sup>2</sup>). ILECs operating in these states may have chosen, on their

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<sup>1</sup>Illinois Bell Telephone Company: Petition to Regulate Rates and Charges of Noncompetitive Services Under An Alternative Form of Regulation; Citizens Utility Board -vs- Illinois Bell Telephone Company: Complaint for an investigation and reduction of Illinois Bell Telephone Company's rates under Article IX of the Public Utilities Act, Illinois Commerce Commission, 92-0448; 93-0239 Consol, October 11, 1994.

<sup>2</sup>Depreciation Order at ¶ 17.

own, to implement an amortization. But an ILEC's decision to implement such an amortization is not tantamount to a state commission decision to "deal with" the differential between the ILECs' financial and regulatory books via an amortization, much less a determination that such an amortization would be recognized for ratemaking purposes. The state commission would be wholly indifferent to the ILEC's depreciation practices.

For example, the New York Performance Regulation Plan (PRP) permits Bell Atlantic considerable freedom to select its own depreciation practices, including the freedom to implement amortizations. But the New York commission has made clear that it is not endorsing Bell Atlantic's depreciation decisions for use in ratemaking or for other regulatory purposes. The PRP's rate ceilings were initialized using state commission-prescribed depreciation rates, not those selected by Bell Atlantic, and Bell Atlantic's subsequent depreciation choices have had no bearing on the rates charged under the PRP.

If the ILECs are successful in obtaining above-the-line treatment from the Commission, it would mark the first time that a regulatory agency has established an amortization to eliminate the differential between an ILEC's financial and regulatory books and has found that such an amortization should be reflected in the ILEC's revenue requirement. The states are concerned that, if the Commission takes such a step, "the presumption will be that those costs should be recovered from intrastate rates" as well.<sup>3</sup> The fact that the ILECs have "committed" not to seek recovery of the amortization expense at the federal level provides little comfort to state commissions. The CALLS ILECs have made clear that they are making this "commitment" only in the narrow context of the CALLS proceeding,<sup>4</sup> and have refused to make similar commitments at the state level.

Even if there were no risk to the states, the Commission could not allow an above-the-line amortization in this proceeding, for the simple reason that above-the-line treatment would be entirely inconsistent with the Commission's findings in the December, 1999 Depreciation Order. An "above-the-line" amortization represents an acceleration of the return of capital. The Depreciation Order's core finding was that current Commission depreciation practices already permit appropriate recovery of capital.<sup>5</sup> Given that the

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<sup>3</sup>Letter from Joe Garcia, Chairman, Florida Public Service Commission, to William E. Kennard, Chairman, FCC, CC Docket No. 98-137, May 25, 2000, at 2.

<sup>4</sup>See, e.g., BellSouth Comments at 4 n.4 ("[I]f the CALLS Plan were not approved, BellSouth, as other ILECs, would not be willing to forego the recovery of the amortization amount . . . .")

<sup>5</sup>Depreciation Order at ¶¶14-18, 65 ("[W]e do not agree that the incumbent LECs' plant is underdepreciated.")

Commission has found that current depreciation practices already permit appropriate recovery of capital, there would be no basis for the Commission to authorize an acceleration of capital recovery.

Furthermore, the ILECs' proposal for a five-year amortization carries a significant risk of harming interstate ratepayers -- despite the ILECs' "commitment" not to seek recovery of the amortization expense. In the Depreciation Order, the Commission explained that it was requiring the ILECs to agree to a one-time write-off of the entire difference between the ILECs' regulatory and financial books in order to "provide assurance that carriers do not engage in a practice that would disadvantage consumers and competition by using high financial depreciation rates with high regulatory net book costs . . . ." <sup>6</sup> By contrast, under the ILECs' amortization proposal, the upward pressure on ILEC revenue requirements from increased depreciation expense would not be offset immediately by the effect of a lower rate base. In some cases, this could depress ILEC reported earnings sufficiently to trigger a low-end adjustment.

### **The ILECs' Proposal Would Undermine Local Competition and Advanced Services Competition**

Rather than provide support for the ILECs' depreciation proposal, the states' experience confirms that any change to the Commission's depreciation practices at this early stage in the development of local competition would be contrary to the public interest.

As is reflected in the attached table, most CALLS ILEC states have concluded that FCC-prescribed lives should be used in determining unbundled network element (UNE) and interconnection rates. These states have found that the FCC's depreciation factors comply fully with the requirement that the calculation of TELRIC reflect "economic depreciation." Of the states not shown on this table, some, such as Washington, have used similar state-prescribed lives in determining UNE and interconnection prices.<sup>7</sup> Only a handful of CALLS ILEC states (five, by WorldCom's count) have accepted the much shorter lives advocated by the ILECs.

The Commission's expertise was especially valuable to those states that had reduced or eliminated their oversight of ILEC depreciation practices for state ratemaking purposes. Many of the states shown in the table attached to the ILECs' June 1, 2000 letter as permitting "shorter lives" or "amortizations" relied on FCC depreciation factors in UNE cost proceedings. In the absence of recent state depreciation rate prescriptions, the

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<sup>6</sup>Depreciation Order at ¶26.

<sup>7</sup>At least one state, Oklahoma, did not explicitly address depreciation issues in its decision.

depreciation factors established by the Commission represented "the most credible and comprehensive evaluation of depreciation in the record."<sup>8</sup> State commissions found that the FCC's depreciation factors were appropriately forward-looking, and rejected the ILECs' "ill-defined and largely judgmental calculations."<sup>9</sup> The Illinois commission stated, for example, that it did "not believe that financial accounting lives are a suitable proxy for economic lives, as they are often driven by corporate financial objectives, and reflect accounting rules biased toward conservatism."<sup>10</sup>

Because the states have found the FCC's depreciation factors to be so useful, and have so resoundingly rejected the much shorter lives advocated by the ILECs, one of the ILECs' primary objectives in this proceeding is to eliminate or undermine the Commission's role in evaluating ILEC depreciation factors. No doubt, if the Commission permits the ILECs to use their "financial" depreciation rates for regulatory bookkeeping purposes, the ILECs will argue in the next round of state UNE proceedings that the Commission has "endorsed" the use of the ILECs' financial depreciation factors for regulatory purposes. Permitting the ILECs to implement an "above-the-line" amortization would only bolster this argument.

If the ILECs are successful in eliminating or undermining the Commission's role as a source for objective analysis of forward-looking depreciation factors, it would have a negative impact on competition in the local exchange and advanced services markets. Last year, the Common Carrier Bureau noted that, if the Commission's depreciation oversight were weakened, "[s]tates would have little information other than the faster depreciation lives advocated by the companies, which, if adopted by the states, could result in major increases in UNE prices."<sup>11</sup>

In the last round of state TELRIC proceedings, the New York commission noted that the use of ILEC-advocated depreciation factors would increase the price of an unbundled loop by \$1.16 per month.<sup>12</sup> Similarly, the Georgia commission noted that the use of

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<sup>8</sup>Illinois Commerce Commission, Investigation into forward looking cost studies and rates of Ameritech Illinois for interconnection, network elements, transport and termination of traffic, Second Interim Order, 96-0486; 96-0569, February 17, 1998, at 28.

<sup>9</sup>Id. at 27.

<sup>10</sup>Id.

<sup>11</sup>Letter from William E. Kennard, Chairman, FCC, to Senator Ted Stevens, September 14, 1999, Attachment at 3.

<sup>12</sup>New York Public Service Commission, Case No. 95-C-0657, Opinion No. 97-2, Opinion and Order Setting Rates for First Group of Network Elements, April 1, 1997.

ILEC-advocated depreciation factors would increase the price of an unbundled loop by \$0.94.<sup>13</sup>

Such increases in the price of unbundled elements would significantly hamper CLECs' ability to compete successfully in the local exchange market, particularly using UNE-P, and in the market for xDSL and other advanced services. Increases in UNE-P prices would offset whatever pro-competitive benefits the Commission anticipates from the rate restructuring resulting from the CALLS Order. To put matters in perspective, a \$1.16 per line increase in UNE prices would actually exceed the increase in revenue per line for residential lines that the Commission staff has estimated will result from implementation of the CALLS plan.<sup>14</sup> The combination of the CALLS plan and the depreciation changes sought by the ILECs could thus result in less competitive pressure on residential local rates.

### **Conclusion**

As all non-ILEC parties filing comments in this proceeding have urged, the Commission should terminate this proceeding. ILECs seeking depreciation relief should be required to utilize the waiver framework outlined in the December 1999 Depreciation Order.

Sincerely,



Mary L. Brown

cc: Kathy Brown  
Kyle Dixon  
Ken Moran  
Sarah Whitesell  
Dorothy Attwood  
Rebecca Beynon  
Carol Matthey  
Jordan Goldstein

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<sup>13</sup>Georgia Public Service Commission, Docket No. 7061-U, Order Establishing Cost Based Rates, decided October 21, 1997.

<sup>14</sup>Common Carrier Bureau, Industry Analysis Division, CALLS Analysis, May 25, 2000, Graph 10 (estimating that CALLS would increase the average per-line access revenue for primary residential lines by \$1.10, from \$4.73 to \$5.83, in 2004).

### State Depreciation Analysis (TELRIC Cases)

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| <b>Alabama</b><br>Docket No. 96029<br>August 25, 1998      | <p>"In fact, there is a benchmark on which to base forward-looking lives and it is the 1996 FCC depreciation rate represcription for the former Southern Bell Region."</p>  |
| <b>Delaware</b><br>Docket No. 96-324<br>Order No. 4542     | <p>"The Commission agrees that BA-Del's suggested depreciation lives are unrealistically short, and that the FCC lives are the more reasonable ones on this record."</p>  |
| <b>Florida</b><br>Docket No. 960757-TP<br>April 29, 1998   | <p>"Based on the above discussions, we find that use of the life projections proposed by AT&amp;T/MCI witness Majoros and prescribed by the FCC for BellSouth of Florida for the five technology-sensitive accounts is appropriate."</p>  |
| <b>Georgia</b><br>Docket No. 7061-U<br>October 21, 1997    | <p>"For the purposes of the assumptions contained in the cost studies in this proceeding, the Commission will use the plant lives and depreciation rates as prescribed by the FCC for BellSouth's operations in Georgia."</p>   |
| <b>Hawaii</b><br>Docket No. 7702<br>January 1, 1999        | <p>"The depreciation lives we have established are similar to (although not the same as) the lives prescribed by the FCC and are generally within the FCC's national ranges."</p>   |
| <b>Illinois</b><br>Docket No. 96-0569<br>February 17, 1998 | <p>"We believe that the projection lives and future net salvage percentages underlying the depreciation rates prescribed for Ameritech Illinois by the FCC as set forth in the FCC's annual update of depreciation rates should be used in the TELRIC calculations."</p>  |
| <b>Louisiana</b><br>Docket No. U-22022<br>October 24, 1997 | <p>(order adopting UNE rates proposed by Louisiana PSC consultant, who recommended "that the Commission take into consideration BellSouth's lives and salvage values as used by BellSouth for its Louisiana operations, the FCC's approved lives and salvage values for BellSouth's Louisiana operations, and the range of FCC lives and salvage values found reasonable [by the FCC] in Docket No. 92-296.")</p> |
| <b>Maryland</b><br>Case No. 8731<br>September 22, 1997     | <p>"After reviewing the record on this issue, we will accept the consensus of the parties (excepting Bell) that the FCC lives should be utilized at this time in determining the appropriate depreciation rates for pricing unbundled network elements."</p>  |



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| <b>Massachusetts</b><br>D.P.U. 96-73/74<br>December 4, 1996    | <p>"We find, based on this record, that the projection lives prescribed by the FCC in its last represcription of NYNEX's depreciation rates are the kind of forward-looking projection lives required in a TELRIC study."</p>   |
| <b>Nevada</b><br>Docket No. 96-9035<br>February 5, 1998        | <p>"[T]he Commission believes that FCC guidelines are useful. Therefore, the Commission finds that the service lives implicit in the depreciation rates that were agreed upon in S/CTC-N's and Nevada Bell's Par dockets must be used in conducting the cost studies. If these values are outside the FCC-authorized range . . . , the nearest FCC-authorized value will apply by default."</p>   |
| <b>New York</b><br>Opinion No. 97-2<br>April 1, 1997           | <p>"As noted, AT&amp;T offered evidence that recent FCC represcriptions have been more forward-looking. And while New York Telephone takes issue with that premise, noting the continued reliance of the represcription on historical information, it appears that the process has become sufficiently forward-looking to be relied on here."</p> <p>"New York Telephone has not shown why GAAP-based rates are proper, nor has it fully come to grips with the concern that adoption of its GAAP-based depreciation rates would unduly inflate the cost of network elements, in effect requiring its competitors to subsidize its own competitive ventures."</p> |
| <b>North Carolina</b><br>Docket No. P-100<br>December 10, 1998 | <p>"In the context of the FLEC Docket, the Commission found that the FCC-authorized ranges were forward-looking for the purposes of determining the cost of universal service. Therefore, the Commission believes that it is appropriate in this docket to require parties to use as inputs to the TELRIC cost studies economic lives and future net salvage values that are within the FCC-authorized ranges . . . ."</p>  |
| <b>Ohio</b><br>Case No.<br>96922TPUNC<br>June 19, 1997         | <p>"[W]e find that the use of the prescription rates adopted by the FCC in its Order of January 25, 1996 is not inconsistent with the TELRIC methodology and, therefore, its use is reasonable in this context and at this time."</p>   |
| <b>South Carolina</b><br>Docket No. 97-374-C<br>June 1, 1998   | <p>"We agree with Consumer Advocate witness Buckalew that, since depreciation rates have been prescribed by this Commission and the FCC, these rates should be used as input in the TELRIC study."</p>  |

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| <b>Tennessee</b><br>Docket No. 97-01262<br>January 25, 1999  | "BST argues that the asset depreciation lives established by the FCC in 1993 are not accurate because such lives are too long. Nonetheless, BST admits that the book depreciation reserve as of January 1, 1997, using the 1993 FCC prescribed depreciation lives, result in a reserve surplus exceeding \$100,000,000 (one hundred million dollars). This reserve surplus is a result of asset depreciation lives that are too brief rather than too long . . . . Therefore, the Authority finds that BST's TELRIC Calculator model and the Hatfield model should use Tennessee-specific depreciation lives, salvage values, and other inputs used in calculating the depreciation rates established by the TPSC in 1993." |
| <b>Texas</b><br>Docket No. 16189<br>November 7, 1996         | "The Arbitrators find that the record evidence demonstrates that SWBT must use the Average Service Life and Future Net Salvage Value depreciation method prescribed by the FCC, effective June 1996, to calculate the depreciation rates for depreciable plant account categories."   |
| <b>Virginia</b><br>Case No. PUC<br>970005<br>May 22, 1998    | "We adopt the AT&T/MCI-recommended depreciation parameters (Exhibit RBL-78, Attachment 6, Column "FCC-VA"), in which Staff concurred, for forward-looking, economic lives and net salvage percentages."   |
| <b>West Virginia</b><br>Case No. 961516TPC<br>April 21, 1997 | "The Commission will adopt, for the most part, AT&T's argument that the Commission should base BA-WV's depreciation lives on those lives prescribed by the FCC during the represcription process."  |